D.T.E. 04-29

Investigation by the Department of Telecommunications and Energy pursuant to G.L. c. 164, § 94A into the Petition of KeySpan Energy Delivery New England for approval of Gas Sales Agreements with BP Canada Energy Company and Nexen Marketing and an Agency Agreement and a Management Services Agreement with Northeast Gas Markets LLC.

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FOR: KEYSPAN ENERGY DELIVERY NEW ENGLAND
Petitioner

I. INTRODUCTION

On February 24, 2004, KeySpan Energy Delivery New England[1] ("KeySpan" or "Company"), pursuant to G.L. c. 164, § 94A, submitted for approval by the Department of Telecommunications and Energy ("Department") (i) gas sales agreements ("Sales Agreements") that the Company executed with BP Canada Energy Company ("BP") and Nexen Marketing ("Nexen") and (ii) an agency agreement ("Agency Agreement") and a management services agreement ("Management Services Agreement") that the Company executed with Northeast Gas Markets LLC ("NEGM").[2] The Sales Agreements replace two supply contracts between KeySpan and EnCana Corporation ("EnCana").[3] The Agency and Management Services Agreements require NEGM to perform day-to-day administrative services for KeySpan related to the BP and Nexen Sales Agreements. The petition was docketed as D.T.E. 04-29.

On March 24, 2004, pursuant to notice duly issued, the Department conducted a public hearing to afford interested persons the opportunity to comment on KeySpan's proposal. No

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[1] KeySpan is comprised of Boston Gas Company, Essex Gas Company, and Colonial Gas Company.

[2] NEGM is a project development and gas supply contract firm. KeySpan Corporation, KeySpan's parent company, indirectly owns 90 percent of NEGM, thus NEGM is an "affiliated company" of KeySpan within the meaning of G.L. c. 164, § 85 (KS-1, at 13). Because of this affiliate relationship, and because the Management Services Agreement has term of greater than one year and it provides for compensation to be paid by Keyspan to NEGM, it is subject to Department approval pursuant to G.L. c. 164, § 94B.

[3] The EnCana contracts were approved by the Department in KeySpan Energy Delivery New England, D.T.E. 02-54 (2002).

members of the public were in attendance. An evidentiary hearing was held at the Department's offices on April 29, 2004. KeySpan presented the testimony of Elizabeth Arangio, director of customer choice and gas resource management for the Company. The evidentiary record includes thirteen exhibits and one response to a record request.

II. DESCRIPTION OF THE PROPOSED AGREEMENTS

A. Sales Agreements

KeySpan has executed four Sales Agreements, two with BP and two with Nexen, in order to replace western Canadian gas volumes previously being purchased from EnCana (Exh. KS-1, at 5).[4] Under the Sales Agreements, Boston Gas Company will be entitled to purchase up to 5,379 dekatherms ("Dth") of gas per day from BP and 5,379 Dth per day from Nexen (id). Essex Gas Company will be entitled to purchase up to 830 Dth of gas per day from BP and up to 831 Dth per day from Nexen (id.). All of the gas volumes under the Sales Agreements are to be purchased at the United States-Canadian border near Niagara, New York (id.).

According to the Company, the proposed contracts are the result of a competitive bidding process engaged in by KeySpan in conjunction with several other northeast local

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4 Berkshire has entered into a short-term, interim agreements with Nexen and BP for gas purchases pending Department approval of the Sales Agreements.

distribution companies ("LDCs") (collectively, the "Working Group") [5] (id. at 6-7). KeySpan states that the objective of this process was to secure a reliable, competitive replacement for the EnCana commodity contracts (id. at 9).

Pricing under the proposed contracts is tied to the gas-price index published monthly in Platts Inside FERC's Gas Market Report for deliveries at Niagara, plus a charge per Dth as specified in the Sales Agreements (Exhs. KS-1, at 5; EDA-4, at 2). The Company maintains that the Sales Agreements offer several advantages over the EnCana contracts they would replace. In particular, the Company notes that: (1) the Sales Agreements offer monthly flexibility to reduce the Company's gas purchase obligation by up to 100 percent upon five days' prior notice; (2) splitting the volumes to be purchased between two competing marketers adds a measure of reliability and diversity to KeySpan's resource portfolio; (3) the three-year term of the contracts provides a measure of price certainty and supply reliability; (4) the term is short enough to enable the Company to (i) take advantage of more favorable supply when available and (ii) respond to potential changes in the Company's service obligation that may result from the Department's ongoing evaluation of the competitive gas markets in Investigation of Capacity Assignment, D.T.E. 04-1; and (5) the Sales Agreements allow the Working Group members to exchange gas entitlements for any month in which a Working Group member chooses not to nominate its full contract entitlement

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5 The other LDCs include Bay State Gas Company, The Berkshire Gas Company, Connecticut Natural Gas Corporation, The Brooklyn Union Gas Company, d/b/a Keyspan Energy Delivery New York, Energy North Natural Gas, Inc., d/b/a/ Keyspan Energy Delivery New England, Keyspan Gas East Corporation, d/b/a/ Keyspan Energy Delivery Long Island, and Northern Utilities, Inc. (Exh. KS-1, at 3).

(Exh. KS-1, at 5-7). The Company notes that the new contracts are replacement supplies for the EnCana contract volumes that were included in its most recently approved long-range forecast and requirements plan, Keyspan Energy Delivery New England, D.T.E. 01-105 (2003) (id. at 7).[6]

B. Agency Agreement

KeySpan has entered into an Agency Agreement with NEGM under which NEGM would act as KeySpan's administrative agent for all purposes under the Sales Agreements (id. at 13-14; Exh. EDA-6, at 2). Under the Agency Agreement, NEGM will: (1) submit nominations to BP and Nexen; (2) coordinate the exchange among Working Group members of contracted volumes not being purchased by the entitlement holder; (3) process invoices and make payments; (4) declare or receive notice of force majeure; and (5) prepare and file U.S. Customs Department forms and payments (Exh. EDA-6, at 2). The Agency Agreement becomes effective and binding on the effective date of the proposed Sales Agreements and will remain in force until the termination of the Sales Agreements (id. at 7). The Agency Agreement does not provide for any compensation to NEGM for the contracted agency services (id.).

6 KeySpan's EnCana contracts replaced gas volumes previously purchased from Boundary Gas Inc. ("Boundary"). D.T.E. 02-54, at 10. The Boundary gas volumes were included in the Company's most recently approved long-range resource and supply plan. D.T.E. 01-105, at 64 (Att. A).

C. Management Services Agreement

The Working Group has entered into a Management Services Agreement with NEGM under which NEGM would provide operational, management, contract administration, coordination, reporting and accounting services for the administration of the Sales Agreements (Exh. EDA-5, at 1-2). Specifically, NEGM would, inter alia: (1) maintain records of quantities and total heating value of gas sold to KeySpan; (2) transmit and receive notices between KeySpan and its suppliers; (3) coordinate re-offerings of gas entitlements not nominated by other Working Group members; (4) notify KeySpan of the monthly contract prices; (5) prepare and file any required operational reports; (6) analyze and reconcile nominated and received gas volumes; (7) review meter station inspection reports; (8) maintain bank accounts; (9) retain legal and other professional services; (10) verify the accuracy of invoices from suppliers and forward invoices to KeySpan and the Working Group; (11) receive and remit monies owed by KeySpan to the suppliers; and (12) conduct renegotiation and arbitration as necessary under the Sales Agreements (id. at 2-4). KeySpan's obligations under the proposed Management Services Agreement are coterminous with the Sales Agreements (id. at 8-9). NEGM would assess a fee for services rendered under the Management Services Agreement that will vary monthly in accordance with the volume of gas purchased by KeySpan (id. at 4-5).

Because NEGM is an affiliate of KeySpan, under the provisions of G.L. c. 164, § 85 (see n.2 above), the Department will review the Management Services Agreement also under the provisions of G.L. c. 164, § 94B.

D. The Request for Proposals Process

______For the gas sales agreements, the Working Group issued a joint request for proposals ("RFP") that was sent to 22 companies[7] requesting bidders to submit multiple volume, service, contract duration, and pricing options (id. at 9). Ten bidders[8] responded to the RFP (id. at 10). After the bids were reviewed and their price offers were standardized to a common price index, they were evaluated according to the following criteria: price; security of supply; bid flexibility; and rating of supplier (id. at 11). Next, the Working Group developed a short list of bidders who were then asked to refresh their previous bids, emphasizing volume flexibility, delivery point, and pricing options (id. at 12). After reviewing the refreshed bids, the Working Group determined that BP and Nexen offered equivalent bids that represented the best price and overall value (id. at 16).

______As directed by the Department in D.T.E. 02-54, KeySpan conducted an RFP before entering into the proposed Management Services Agreement with NEGM. The Company states that the RFP was sent to four entities.[9] KeySpan states that it considered price and

7 The proposed RFP recipients for EnCana gas replacement supplies were: Amerada Hess Corp.; Apache Canada Ltd.; BP; Canadian Natural Resources Ltd; Cargill; Cinergy; Constellation Power; Coral Energy; DTE Energy; Duke Energy Trading and Marketing; Emera; EnCana Corporation; Husky; Imperial Oil; Marathon Canada; NRJ Energy; NEXEN; Proliance Energy; RWE Trading Americas; Sempra Energy Trading; Sprauge; and Tenaska (Exh. EDA-10).

8 Amerada Hess Corp, BP, Canadian Natural Resources Ltd, Cargill, Coral Energy, DTE Energy, Emera, Husky, NRJ Energy, NEXEN, Sempra Energy Trading, and Sprague submitted bids.

9 The recipients of the management services RFP were Axsess Group, Concentric Energy Advisors, NEGM, and Pace Global Energy Services (Exh. EDA-25).

non-price factors (Tr. at 15). Upon review of the bids, KeySpan determined that NEGM's expertise and rate made it the only potential provider for this type of service (KS-1, at 16).[10]

III. STANDARD OF REVIEW

A. Section 94A

In evaluating a gas utility's resource options for the acquisition of commodity resources as well as for the acquisition of capacity under G.L. c. 164, § 94A ("Section 94A"), the Department examines whether the acquisition of the resource is consistent with the public interest. Commonwealth Gas Company, D.P.U. 94-174-A at 27 (1996). In order to demonstrate that the proposed acquisition of a resource that provides commodity and/or incremental resources is consistent with the public interest, an LDC must show that the acquisition (1) is consistent with the company's portfolio objectives and (2) compares favorably to the range of alternative options reasonably available to the company and its customers, including releasing capacity to customers migrating to transportation, at the time of the acquisition or contract negotiation. Id.

In establishing that a resource is consistent with the company's portfolio objectives, the company may refer to the portfolio objectives established in a recently approved forecast and requirements plan or in a recent review of supply contracts under Section 94A, or may describe its objectives in the filing accompanying the resource proposal. Id. In comparing the proposed resource acquisition to current market offerings, the Department examines relevant

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10 According to the Company, NEGM was given an opportunity to refresh its bid, while the next highest scoring bidder was not given the same opportunity (Tr. at 27-28).

price and non-price attributes of each contract to ensure a contribution to the strength of the overall supply portfolio. Id. at 28. As part of the review of price and non-price attributes, the Department considers whether the pricing terms are competitive with those of the broad range of capacity, storage, and commodity options that were available to the LDC at the time of the acquisition, as well as those opportunities that were available to other LDCs in the region. Id. In addition, the Department determines whether the acquisition satisfies the LDC's non-price objectives, including, but not limited to, flexibility of nominations and reliability and diversity of supplies. Id. at 29. In making these determinations, the Department considers whether the LDC used a competitive solicitation process that was fair, open and transparent. The Berkshire Gas Company, D.T.E. 02-56, at 9; Bay State Gas Company, D.T.E. 02-52, at 8 (2002); KeySpan Energy Delivery New England , D.T.E. 02-54, at 9 (2002); The Berkshire Gas Company, D.T.E. 02-19, at 11 (2002).

B. Section 94B

When a petitioner is an "affiliated company" within the meaning of G.L. c. 164, § 85, it is subject to Department approval pursuant to G.L. c. 164, § 94B ("Section 94B"). Section 94B provides in pertinent part:

> No gas or electric company shall, without the approval of the [D]epartment, hereafter enter into a contract with a company related to it as an affiliated company, as defined in section eighty-five, covering a period in excess of one year, by virtue of which any compensation is paid by the said gas or electric company in whole or in part for services rendered by said affiliated company…

The statute does not set forth an explicit standard of review, so, therefore, Department case precedent provides a basis for the Department's review under Section 94B. In evaluating contracts under Section 94B, the Department requires utilities to demonstrate that (1) the contract provides a reasonable method of allocating liabilities and benefits between a utility company and its affiliate and (2) the methods employed in structuring the contract are sufficient to protect the interests of a utility company's ratepayers. Boston Edison Company, D.P.U. 95-77, at 3 (1995); Boston Edison Company, D.P.U. 93-37-A at 2 (1994). In reviewing a services agreement under this standard, the Department, at a minimum, examines whether the terms of the agreement adequately ensure that the utility's ratepayers are not subsidizing the affiliate's operations, and that the provisions of the agreement are sufficient to minimize a utility's liabilities and ratepayer exposure with respect to the affiliate's operations. D.P.U. 95-77, at 3-4; Boston Edison Company, D.P.U. 93-37, at 16 (1993); D.P.U. 93-37-A at 2-3.

IV. ANALYSIS AND FINDINGS

A. The Request for Proposals Process

1. Sales Agreement Request for Proposal

The Department notes that the bid solicitation and evaluation process followed by Keyspan and the Working Group for procurement of gas supplies in this proceeding was similar to the process approved in recent proceedings. See Bay State Gas Company, D.T.E. 02-52, at 8 (2002); Keyspan Energy Delivery New England, D.T.E. 02-54, at 9 (2002); The Berkshire Gas Company, D.T.E. 02-56, at 9 (2002). In determining whether the RFP process was fair, open, and transparent the Department finds that potential bidders were notified on the specifics of how each bid would be evaluated. Specifically, the evidence shows that the evaluation process had been clearly stated to each potential bidder, the evaluation criteria were provided, and there was an opportunity for bidders to request clarification on both the evaluation criteria and the RFP process itself (Exh. EDA-5,at 9). In addition, the bids were evaluated and the winning bid was selected based on the criteria set forth in the RFP (id. at 11). Furthermore, the Company received no objections from potential bidders to indicate that a bidder was unfairly excluded from initial consideration or that a bid was unfairly evaluated. Finally, our review of the responses to the RFP indicates that the Company's proposal compares favorably to current market offerings considering price and non-price factors, as well as current market conditions facing the Company at the time of the execution of the Agreement. Accordingly, the Department finds that the RFP process conducted by the Working Group and followed by KeySpan for the procurement of gas supplies was transparent, fair and open. However, in the future, in the interest of maximizing transparency, the Department directs KeySpan to include in any RFP both the criteria by which proposals will be evaluated as was provided in this RFP and the weighting factors to be applied to each criterion in evaluating each bid.

2. Management Services Agreement Request for Proposal

______The Department directed KeySpan to conduct an RFP to test the market for alternative offerings available to it before renewing the Agency and Management Services Agreements with NEGM or, alternatively, to provide evidence to show that there is no other entity that is capable of providing similar services as NEGM. D.T.E. 02-54, at 11-12. The Company stated that it sent the management services RFP to four entities known by the Company to provide services similar to those provided by NEGM (Exh. KS-1, at 16). Three of those entities responded by submitting bids (Exh. EDA-26; Tr. at 26.). The Department finds that it is appropriate to review the RFP process in accordance with the RFP review standard applied above, that is, the management services RFP process will be deemed acceptable if the process was fair, open, and transparent.

The Department finds it appropriate that the Company used both price and non-price criteria to evaluate the bids. The Department notes that it has received no objections from potential bidders to indicate that a bidder was unfairly excluded from initial consideration or that a bid was unfairly evaluated. Accordingly, the Department finds that the RFP process for the management services agreement was fair and open. The Department recognizes the value of the extensive experience that NEGM has in working with KeySpan in managing contracts for gas supply from Canada. However, we are concerned that the Company would provide one bidder an opportunity to revise its price offer, while not extending the same opportunity to a very close, second place finisher. Requesting refresher bids is standard practice and, to the extent refreshed bids result in lower costs to the Company, they are in the interest of both ratepayers and shareholders and are encouraged by the Department. The Department directs the Company to include, in future management services RFPs, both the criteria by which proposals will be evaluated and the weighting factors to be applied to each criterion in evaluating each bid. This requirement should alleviate concern that any one bidder might be given an unfair advantage in the design and formulation of its bid by having disproportionate access to the Company's RFP evaluation methodology. Furthermore, the Department directs the Company to uniformly apply to all bidders any opportunity to refresh bids.

B. Sales Agreements

The Department's review of the proposed Sales Agreements indicates that they are consistent with the Company's resource portfolio objectives presented in the Company's most recent forecast and requirements plan approved by the Department in Keyspan Energy Delivery New England, D.T.E. 01-105 (2003). Both the BP and Nexen resources compare favorably to the range of alternatives reasonably available to the Company and its customers at the time of the agreements, and enhance the supply diversity and reliability attributes of the Company's resource portfolio (Exh. EDA-1, at 6). Furthermore, KeySpan's participation in the Working Group ensured that the Company enjoyed substantial economies of scale in securing a least-cost replacement resource. Accordingly, the Department finds that the Sales Agreements are consistent with the public interest, and we approve the Company's proposal.

C. Agency and Management Services Agreements

We conclude that the services to be performed under the Agency and the Management Services Agreements are necessary and consistent with KeySpan's portfolio objectives established in the Company's approved forecast and requirements plan, D.T.E. 01-105 (2003).

The Department is aware that NEGM has had a long-working relationship with the Working Group, and that NEGM has substantial Canadian gas contracting experience. Bay State Gas Company, D.T.E. 02-52, at 10 (2002); The Berkshire Gas Company, D.T.E. 02-56, at 12 (2002). Furthermore, the services that NEGM shall provide under these agreements are a continuation of the services that NEGM currently provides to the Company under the EnCana agreements. KeySpan Energy Delivery New England, D.T.E. 02-54, at 11 (2002). Under the Management Services Agreement, NEGM will provide these same services at a lower rate than it charged under the EnCana agreements (Exh. EDA-1 at 16). Therefore, the Department finds that the Company's ratepayers likely will benefit through lower costs as a result of the expertise and experience of NEGM. Because the services to be provided by NEGM are explicitly detailed in the agreements and because pricing under the Management Services Agreement based on the volumes purchased is reasonable, the Department finds that there is a reasonable means of allocating benefits and liabilities between the Company and NEGM. We further find that the provisions of the Agency and Management Services Agreements are sufficient to protect the Company's ratepayers from subsidizing the operations of NEGM. For these reasons, the Department finds that the Agency and the Management Services Agreements are consistent with the public interest, and we approve them. However, in order to ensure optimum benefits for KeySpan's ratepayers, the Department directs KeySpan to conduct a separate solicitation to test the market or provide evidence to show that there is no other entity that is capable of providing similar services before renewing these agreements.

V. ORDER

Accordingly, after due notice, hearing and consideration, it is hereby

ORDERED: That the two gas sales agreements with BP Energy Canada Company and KeySpan Energy Delivery New England are hereby APPROVED; and it is

FURTHER ORDERED: That the two gas sales agreements with Nexen Marketing and KeySpan Energy Delivery New England are hereby APPROVED; and it is

FURTHER ORDERED: That the agency agreement between Northeast Gas Markets LLC and KeySpan Energy Delivery New England is hereby APPROVED; and it is

FURTHER ORDERED: That the management services agreement between and Northeast Gas Markets LLC and KeySpan Energy Delivery New England is hereby APPROVED; and it is

FURTHER ORDERED: That KeySpan Energy Delivery New England shall follow all other directives contained in this Order.

By Order of the Department,

/s/________________________________
Paul G. Afonso, Chairman

/s/________________________________
James Connelly, Commissioner

/s/________________________________
W. Robert Keating, Commissioner

/s/________________________________
Eugene J. Sullivan, Jr., Commissioner

/s/________________________________
Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Act of 1971).